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May 6, 2009

VIA FACSIMILE

Ms. LaDonna Castañuela
Texas Commission on Environmental Quality
Office of Chief Clerk, MC 105
P. O. Box 13087
Austin, Texas 78711-3087

Re: SOAH Docket No. 582-08-1700; TCEQ Docket No. 2008-0091-UCR; *Petition of Ratepayers Appealing Rates Established by Clear Brook City Municipal Utility District;*
SOAH Docket No. 582-08-2863; TCEQ Docket No. 2008-0093-UCR; *Appeal of the Retail Water and Wastewater Rates of the Lower Colorado River Authority;*
SOAH Docket No. 582-09-1168; TCEQ Docket No. 2008-1645-UCR; *Petition of West Travis County Municipal Utility District No. 3 for Review of Raw Water Rates*

Dear Ms. Castañuela:

Enclosed please find Clear Brook City Municipal Utility District's Brief on the Administrative Law Judges' Request for Answers to Certified Questions for filing.

If you have questions, please contact me at (713) 651-5493.

Very truly yours,

Paul C. Sarahan

PCS/kyb
Enclosure

Cc: Administrative Law Judges
Hon. William G. Newchurch
Hon. Henry D. Card
Hon. Kerrie Qualtrough
State Office of Administrative Hearings
300 West 15th St., Suite 502
Austin, Texas 78701

Service List

SOAH DOCKET NO. 582-08-1700
TCEQ DOCKET NO. 2008-0091-UCR

PETITION OF RATEPAYERS APPEALING RATES ESTABLISHED BY CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

SOAH DOCKET NO. 582-08-2863
TCEQ DOCKET NO. 2008-0093-UCR

APPEAL OF THE RETAIL WATER AND WASTEWATER RATES OF THE LOWER COLORADO RIVER AUTHORITY	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

SOAH DOCKET NO. 582-09-1168
TCEQ DOCKET NO. 2008-1645-UCR

PETITION OF WEST TRAVIS COUNTY MUNICIPAL UTILITY DISTRICT NO. 3 FOR REVIEW OF RAW WATER RATES	§	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT'S BRIEF ON THE ADMINISTRATIVE LAW JUDGES' REQUEST FOR ANSWERS TO CERTIFIED QUESTIONS

TO THE HONORABLE COMMISSIONERS OF THE TCEQ:

COMES NOW, Clear Brook City Municipal Utility District (the "District") and files its Brief on the Administrative Law Judges' Request for Answers to Certified Questions. Specifically, on May 1, 2009, the Administrative Law Judges ("ALJs") in three proceedings pending before the State Office of Administrative Hearings ("SOAH") certified the following questions:

1. Is Texas Water Code section 49.2122 so inconsistent with Texas Water Code section 13.043(j) that the two statutory provisions cannot be harmonized?

2. Does Texas Water Code section 49.2122(b) create a presumption that rates set by a district are properly established absent a showing that the district action setting the rates was arbitrary and capricious?

3. Does Texas Water Code section 49.2122(b) only create a presumption that customer classes established by a district are properly established absent a showing that the district action establishing the classes was arbitrary and capricious?

4. If the answer to Question No. 2 is YES, does Texas Water Code section 49.2122(b) require the petitioner to make an initial showing that the district's rate-setting action was arbitrary and capricious?

5. If the answer to Question No. 4 is YES, in the circumstance that there is no showing that the district action setting the rates was arbitrary and capricious and the rates are therefore presumed to be "properly established," is there any further inquiry required into whether the rates themselves are valid? If so, what is the standard under which the rates themselves must be judged?

6. If the answer to Question No. 2 is YES, is the petitioner required to make the initial showing the district's rate-setting action was arbitrary and capricious whether the rate affected is for retail service, wholesale service, or raw water?

I. Overview

In 2007, the Legislature enacted Texas Water Code section 49.2122, which states:

ESTABLISHMENT OF CUSTOMER CLASSES. (a) Notwithstanding any other law, a district may establish different charges, fees, rentals, or deposits among classes of customers that are based on any factor the district considers appropriate, including:

(1) the similarity of the type of customer to other customers in the class, including:
- (A) residential;
- (B) commercial;
- (C) industrial;
- (D) apartment;
- (E) rental housing;
- (F) irrigation;
- (G) homeowner associations;
- (H) builder;
- (I) out-of-district;
- (J) nonprofit organization; and
- (K) any other type of customer as determined by the district;

(2) the type of services provided to the customer class;

(3) the cost of facilities, operations, and administrative services to provide service to a particular class of customer, including additional costs to the district for security, recreational facilities, or fire protection paid from other revenues; and

(4) the total revenues, including ad valorem tax revenues and connection fees, received by the district from a class of customers relative to the cost of service to the class of customers.

(b) A district is presumed to have weighed and considered appropriate factors and to have properly established charges, fees, rentals, and deposits absent a showing that the district acted arbitrarily and capriciously.

The three cases that have been abated pending the Commission's consideration of the certified questions involve the interpretation and application of Texas Water Code section 49.2122. These cases are the first matters involving this relatively new statute that have been taken through the contested case hearing process. In each case, the parties have presented arguments to the Administrative Law Judge regarding the effect of Texas Water Code section 49.2122 on the proceedings. Issues have been presented to the Administrative Law Judge regarding the applicability of Texas Water Code section 49.2122 to the proceeding; the placement of the burden of proof on the parties under Texas Water Code section 49.2122; the effect of Texas Water Code section 49.2122 on Texas Water Code section 13.043(j); and the level of proof required under Texas Water Code section 49.2122 to show that a district acted "arbitrarily and capriciously," among other issues.

These cases represent cases of first impression, and the issues presented for the Commission's consideration are central to the proper disposition of these matters. The District respectfully requests that the Commission accept the certified questions, and establish a briefing schedule to allow the parties to more fully brief these important issues for the Commission's consideration.

II. Request for Additional Certified Question

The District respectfully requests that the Commission agree to answer one additional question: "What does "arbitrarily and capriciously" mean in the context of an appeal of a rate setting action taken by a district under Texas Water Code section 49.2122?" This issue has been raised in the pending matter involving the District.

In considering this issue, the Administrative Law Judge in the District's matter looked at the use of "arbitrarily and capriciously" in Texas Water Code section 49.2122(b) and compared it to the use of "just and reasonable" in Texas Water Code section 13.043(j). The Judge found "no meaningful distinction between the words 'arbitrarily' or 'capriciously' or between 'just' and 'reasonable.'" *Petition of Ratepayers Appealing Rates Established by Clear Brook City Municipal Utility District*, Order No. 6, p. 10 He concluded that "one acts unjustly and unreasonably if one acts arbitrarily and capriciously. *Id.*

The Petitioner in the District's matter, TCR Highland Meadow Limited Partnership ("TCR") filed a Motion for Reconsideration of Order No. 6, a copy of which is attached hereto as Exhibit A. In the Motion for Reconsideration, TCR contended that Texas Water Code section 49.2122(b) did not shift the burden of proof to TCR and that, to overcome the presumption set forth in Texas Water Code section 49.2122(b), TCR was merely required to provide "more than a scintilla of evidence showing that the [District] 'acted arbitrarily and capriciously.'" Exhibit A, pp. 1-3.

The District countered, stating that the phrase "arbitrarily and capriciously" in Texas Water Code section 49.2122(b) is used in the context of a challenge to a rate action taken by a district. A copy of the District's Response to the Motion for Reconsideration of Order No. 6 is attached hereto as Exhibit B. The phrase "arbitrarily and capriciously" establishes the legal standard of proof that must be met to overcome the legal presumption established in Texas Water Code section 49.2122. Primary jurisdiction over such a challenge is with the Texas Commission on Environmental Quality. It is reasonable therefore, when considering the meaning of "arbitrarily and capriciously," to determine the meaning of the phrase in the context of administrative proceedings. In short, "arbitrarily and capriciously" is a legal term of art.

The terms "arbitrary or capricious" are used in the Administrative Procedure Act when defining the scope of review of a decision in a contested case. *See* TEX. GOV'T CODE §

2001.174. Although these terms are not defined in the Administrative Procedure Act, case law has developed, in the context of administrative proceedings, regarding the terms "arbitrary and capricious," "arbitrarily or capriciously," and "arbitrary." When construing a statute, courts presume that the Legislature acted with knowledge of the common law and court decisions in enacting the statute. *Phillips v. Beaber*, 995 S.W.2d 655, 658 (Tex. 1999). It can be presumed that the Legislature chose the phrase "arbitrarily and capriciously" to establish the legal standard precisely because it was a standard commonly understood in the practice of administrative law.

In Order No. 7, the ALJ denied the Motion to Reconsider. A copy of Order No. 7 is attached hereto as Exhibit C. Through Order No. 7, the ALJ determined that the District is presumed to have weighed and considered appropriate factors and to have properly established rates absent a showing by a preponderance of the evidence that the District acted arbitrarily and capriciously. The ALJ did not alter his determination of what it meant for the District to have "acted arbitrarily and capriciously" and he declined to treat "arbitrarily and capriciously" as a legal standard, as was contended by the District.

Certified questions address the Commission's interpretation of its rules and applicable statutes. 30 TEX. ADMIN. CODE § 80.131(b)(1). The issue of what "arbitrarily and capriciously" means in the context of an appeal of a rate setting action taken by a district falls within the scope of issues that can be considered by the Commission through a certified question. The Commission's consideration of this issue and its response will allow the cases pending before SOAH and those brought in the future to be processed more efficiently. As such, the District respectfully submits that the parties in the pending proceedings and future litigants will benefit from a determination by the Commission with respect to this issue. Certification of the District's proposed question would also further the interest of judicial economy and allow the parties to better assess their respective legal positions and litigation risks. The District respectfully requests that the Commission agree to answer the following question: "What does "arbitrarily

and capriciously" mean in the context of an appeal of a rate setting action taken by a district under Texas Water Code section 49.2122?"

Prayer

WHEREFORE, PREMISES CONSIDERED, Clear Brook City Municipal Utility District respectfully requests that the Commission:

(1) agree to answer the questions certified by the Administrative Law Judges in the above-referenced matters on May 1, 2009;

(2) agree to answer the following question: "What does "arbitrarily and capriciously" mean in the context of an appeal of a rate setting action taken by a district under Texas Water Code section 49.2122?"; and

(3) establish a briefing schedule to allow the parties to more fully brief these important issues for the Commission's consideration.

Respectfully submitted,

FULBRIGHT & JAWORSKI L.L.P.

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Attorneys for Respondent,
CLEAR BROOK CITY MUNICIPAL
UTILITY DISTRICT

CERTIFICATE OF SERVICE

I certify that a true copy of Clear Brook City Municipal Utility District's Brief on the Administrative Law Judges' Request for Answers to Certified Questions was sent by facsimile on May 6, 2009 to all of the parties on the three attached Service Lists and to the following:

Administrative Law Judges
Hon. William G. Newchurch
Hon. Henry D. Card
Hon. Kerrie Qualtrough
State Office of Administrative Hearings
300 West 15th St., Suite 502
Austin, TX 78701

PAUL C. SARAHAN

TCEQ DOCKET NO. 2008-0091-UCR
SOAH DOCKET NO.582-08-1700

TCR HIGHLAND MEADOW LIMITED PARTNERSHIP	§	**BEFORE THE STATE OFFICE**
Petitioner	§	
	§	
v.	§	**OF**
	§	
CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT	§	
Respondent	§	**ADMINISTRATIVE HEARINGS**

TCR HIGHLAND MEADOW LIMITED PARTNERSHIP'S
MOTION FOR RECONSIDERATION OF ORDER NO. 6

TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

TCR HIGHLAND MEADOW LIMITED PARTNERSHIP ("Petitioner") files this Motion for Reconsideration of Order No. 6 ("Motion"), and would show as follows:

I. ARGUMENT & AUTHORITIES

A. The "Presumption" in Water Code § 49.2122(b) Does Not Shift the "Burden of Proof"

1. Order No. 6 concludes that Water Code § 49.2122(b) relieves Clear Brook City Municipal Utility District (the "MUD") of its "burden of proving that its rates are just and reasonable . . . until TCR first shows that Clear Brook acted arbitrarily and capriciously." *See* Order No. 6, at p. 11.

2. TCR asserts that nothing in Water Code § 49.2122(b) changes the "burden of proof" under Water Code § 13.043(j) or 30 TAC § 291.12.

EXHIBIT A

3. First, in the context of Water Code § 49.2122(b) the Legislature chose[1] to the term "presumption" not "burden of proof." Thus, contrary to the Order No. 6, there is no conflict between Section 49.2122(b) and 30 TAC § 291.12. Without such a conflict, Water Code § 13.043(j) or 30 TAC § 291.12 should determine which party has the burden of proof—"the provider of water and sewer services."

4. Furthermore, there is a clear distinction in Texas law between a "presumption" and an applicable "burden of proof" to be applied in a case. The Texas Supreme Court has held that a "presumption does not constitute evidence in itself or shift the burden of proof." *Republic Nat'l Life Ins. Co. v. Heyward*, 536 S.W.2d 549, 558 (Tex. 1976). Therefore, the presumption set forth in Water Code § 49.2122(b) does not change the burden of proof from the MUD to TCR. Accordingly, Order No. 6 should be modified to reflect that the MUD has the initial burden of proof to show that its rates are "just and reasonable."

B. To Overcome the "Presumption" in Water Code § 49.2122(b), TCR Need Only Provide More Than a Scintilla of Evidence that the MUD Acted Arbitrarily and Capriciously

5. Irrespective of whether TCR or the MUD has the burden of proof, TCR asserts that the "presumption" in Water Code § 49.2122(b) "'disappears' when evidence to the contrary is introduced." *Heyward*, 536 S.W.2d at 558. In other words, the "presumption" is overcome when TCR provides more than a scintilla of evidence showing that the MUD "acted arbitrarily and capriciously." *See* TEX. WATER CODE § 49.2122(b). To be sure, the Legislature has not specified what level of proof is required to overcome the "presumption" in Water Code § 49.2122(b) as it has in other statutes. *E.g.*, *Dixon v. Dewhurst*, 169 S.W.3d 515, 517 (Tex. App.—Texarkana 2005, no

[1] "Every word of a statute is presumed to have been used for a purpose, and the cardinal rule of statutory construction requires that each sentence, clause, phrase and word be given effect if reasonably possible." *City of Mo. City v. State ex rel. City of Alvin*, 123 S.W.3d 606, 614 (Tex. App.—Houston [14th Dist.] 2003, pet. denied).

pet.) (discussing level of proof required, under the Administrative Procedures Act, to overcome presumption that administrative agency's decision is correct is "substantial evidence," which is "more than a scintilla and is enough relevant evidence that a reasonable mind could come to the same conclusion"); *Harrison v. Stanley*, 193 S.W.3d 581, 583-84 (Tex. App.—Houston [1st Dist.] 2006, pet. denied) (discussing the level of proof, under the Texas Election Code, to overcome the presumption that an election was valid is by clear and convincing evidence). Because the Legislature did not require a heightened level of proof to overcome the Water Code § 49.2122(b) presumption, TCR contends that it should only have to provide more than a scintilla of evidence that the MUD "acted arbitrarily and capriciously" to overcome this presumption.

II. RELIEF SOUGHT

6. Based upon the foregoing, TCR requests that the ALJ reconsider Order No. 6, and that upon reconsideration of the same and this Motion, that the ALJ issue an order that is consistent with Water Code § 13.043(j) or 30 TAC § 291.12, placing the burden of proof on the MUD to prove that its rates are "just and reasonable," that the ALJ issue an order requiring the MUD to prefile and present its direct case first, and that the ALJ issue an order declaring that to overcome the "presumption" in Water Code § 49.2122(b), TCR need only provide more than a scintilla of evidence that the MUD "acted arbitrarily and capriciously."

7. TCR requests a hearing be set on its Motion.

III. PRAYER

WHEREFORE, PREMISES CONSIDERED, Petitioner, TCR HIGHLAND MEADOW LIMITED PARTNERSHIP, prays that its Motion for Reconsideration of Order No. 6 be GRANTED, that a hearing be set on the same, that the relief requested herein above be GRANTED, and that Petitioner, TCR HIGHLAND MEADOW LIMITED PARTNERSHIP receive such other and further relief, general and special, both at law and equity, to which it may show itself to be justly entitled.

Respectfully submitted,

TCR HIGHLAND MEADOW LIMITED PARTNERSHIP

By, and through, its attorneys of record:

HOOVER SLOVACEK LLP

By: _____

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SOAH DOCKET NO. 582-08-1700
TCEQ DOCKET NO. 2008-0091-UCR

TCR HIGHLAND MEADOW LIMITED PARTNERSHIP,	§	**BEFORE THE STATE**
Petitioner,	§	
v.	§	**OF**
CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT,	§	
Respondent	§	**ADMINISTRATIVE HEARINGS**

CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT'S RESPONSE TO TCR HIGHLAND MEADOW LIMITED PARTNERSHIP'S MOTION FOR RECONSIDERATION OF ORDER NO. 6

TO THE HONORABLE ADMINISTRATIVE LAW JUDGE:

COMES NOW CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT (the "District") and files this its Response to TCR Highland Meadow Limited Partnership's Motion for Reconsideration of Order No. 6, and would show as follows:

I.
Background

1. On October 22, 2008, the Administrative Law Judge issued Order No. 6 in this matter, concluding that Tex. Water Code § 49.2122(b):

- creates a presumption that Clear Brook's rates are just and reasonable;
- assigns to TCR the burden of proving that Clear Brook acted arbitrarily and capriciously, which is synonymous with unjustly and unreasonably, in weighing and considering appropriate factors and properly establishing rates;
- is a later enacted statute that conflicts with 30 TAC § 291.12, concerning burden of proof, and Water Code § 49.2122(b) prevails;
- does not, nor does Water Code § 49.2122(a), conflict with Water Code § 13.043(j), which requires Clear Brook's rates to be just, reasonable, etc.; and

EXHIBIT B

- relieves Clear Brook of the burden of proving that its rates are just and reasonable, which it would otherwise have under Water Code § 13.043(j) and 30 TAC § 291.12, until TCR first shows that Clear Brook acted arbitrarily and capriciously.

2. TCR Highland Meadow Limited Partnership ("TCR") filed its Motion for Reconsideration on October 23, 2008. TCR's motion asserted: (a) nothing in Water Code § 49.2122(b) changes the "burden of proof" under Water Code § 13.043(j) and 30 TAC § 291.12; and (b) TCR should only have to provide more than a scintilla of evidence that the District "acted arbitrarily and capriciously" to overcome the presumption.

II.

Argument & Authorities

A. TCR Has the Burden of Proof to Show the District Acted Arbitrarily and Capriciously

3. The statute at issue in this matter is Water Code § 49.2122. Under this statute, "Notwithstanding any other law," the District "may establish different charges ... among classes of customers based on any factor the district considers appropriate, including:

- the similarity of the type of customer to other customers in the class;
- the type of services provided to the customer class;
- the cost of facilities, operations and administrative services to provide service to a particular class, including additional costs for security, recreational facilities, and fire protection; and
- the total revenues, including ad valorem tax revenues and connection fees, received by the district from a class of customers relative to the cost of service to the class of customers.

TEX. WATER CODE § 49.2122(a).

4. A district is presumed to have weighed and considered appropriate factors and to have *properly established charges* and fees *absent a showing* that the district acted arbitrarily and capriciously. TEX. WATER CODE § 49.2122(b) (emphases added). This threshold issue is one on which TCR has the burden of proof.

5. TCR contends that the Legislature's use of "presumed" rather than "burden of proof" is determinative. As TCR notes, when possible to do so, effect must be given to every sentence, clause and word of a statute so that no part thereof be rendered superfluous. *City of Marshall v. City of Uncertain*, 206 S.W.3d 97, 105 (Tex. 2006); *City of Missouri City v. State ex rel. City of Alvin*, 123 S.W.3d 606, 614 (Tex. App. – Houston [14th Dist.] 2003, pet. denied); *see also* TEX. GOV'T CODE § 311.021(2).

6. TCR's analysis fails to comply with this fundamental standard of statutory interpretation by completely omitting a consideration of the concluding phrase of Water Code § 49.2122(b) – "absent a showing that the district acted arbitrarily and capriciously." Under the plain language of the statute,[1] the District's rates are presumed to have been properly established or set unless a party shows, i.e., proves, that the District acted arbitrarily and capriciously. Logically, TCR, as the appellant contesting the District's rates, has the burden to make such a showing.

7. TCR contends further that there is a distinction between a presumption and an applicable burden of proof, citing *Republic Nat'l Life Ins. Co. v. Heyward*, 536 S.W.2d 549, 558 (Tex. 1976). In *Heyward*, the Court considered a common law presumption that, where there is evidence of death by violent and external means, it is presumed that the insured did not commit suicide. *Id.*

[1] *City of Marshall v. City of Uncertain*, 206 S.W.3d 97, 105 (Tex. 2006) ("A court, in construing a statute, looks first to the plain and ordinary meaning of the statute's words").

8. In contrast, Water Code § 49.2122(b) includes a legislatively-created presumption and specifies the standard of proof TCR must provide to overcome the presumption. As the Administrative Law Judge has determined, Water Code § 49.2122(b) requires TCR to show that the District acted arbitrarily and capriciously to defeat the presumption that the rates were properly established. TCR's motion for reconsideration of Order No. 6 should be denied in this regard.

B. TCR Misstates Its Burden of Proof

9. TCR contends the presumption established by Water Code § 49.2122(b) is overcome when TCR provides more than a scintilla of evidence showing that the District acted arbitrarily and capriciously. TCR also argues, "To be sure, the Legislature has not specified what level of proof is required to overcome the 'presumption' in Water Code § 49.2122(b)." TCR is incorrect in both instances.

Level of Proof is Specified in Water Code § 49.2122(b)

10. As discussed above, the Legislature established a presumption and specified the level of proof necessary to overcome the presumption in Water Code § 49.2122(b). Absent a showing that the District acted arbitrarily and capriciously, the District's rates are presumed valid. Contrary to TCR's assertion, the Legislature specified this heightened level of proof, and through the heightened level of proof, gave districts broad discretion in setting rates. TCR's assertion that the Legislature has not specified the level of proof necessary for TCR to overcome the presumption in this matter is incorrect.

TCR Must Show There Is No More Than A Scintilla of Evidence Supporting District's Decision

11. TCR's contention that it can overcome the presumption by providing more than a scintilla of evidence showing that the District acted arbitrarily and capriciously is also in error. TCR has cited *Dixon v. Dewhurst*, 169 S.W.3d 515 (Tex. App. – Texarkana 2005, no pet.) in support of its position in this regard. However, TCR's position is entirely contrary to the court's analysis in that case.

12. As the *Dixon* court notes, a reviewing court is extremely protective of an agency's decision. *Id.*, at 517. The *Dixon* court was considering a case under the substantial evidence standard or review. "The cases applying the [substantial evidence] standard presumes that the Board's order is supported by substantial evidence and that the plaintiff has the burden to overcome this presumption." *Id.*; *see also El Paso v. Public Util. Com'n of Texas*, 883 S.W.2d 179, 185 (Tex. 1994). Substantial evidence is a limited standard of review, requiring only more than a mere scintilla of evidence to support an agency's determination. *Montgomery Indep. Sch. Dist. v. Davis*, 34 S.W.3d 559, 566 (Tex. 2000). The order will be upheld if there is "enough relevant evidence that a reasonable mind could come to the same conclusion." *Dixon*, 169 S.W.3d at 517, *citing, Firemen's and Policemen's Civil Serv. Com'n v. Brinkmeyer*, 662 S.W.2d 953 (Tex. 1984). Further, the evidence in the record may even preponderate against the decision and nevertheless amount to substantial evidence such that the decision must be upheld. *Dixon*, 169 S.W.3d at 517, *citing, Tex. Health Facilities Com'n v. Charter Medical-Dallas, Inc.*, 665 S.W.2d 446, 452 (Tex. 1984); *see also El Paso v. Public Util. Com'n of Texas*, 883 S.W.2d 179, 185 (Tex. 1994).

13. Under this analysis, TCR must show that there is no more than a scintilla of evidence supporting the District's decision. TCR's analysis is completely counter to the case law it cites in support of its position.

Arbitrarily and Capriciously

14. The Administrative Law Judge correctly noted in Order No. 6 that "arbitrarily and capriciously" is not defined in the Water Code. A court may look to the context of an undefined statutory term to determine the Legislature's intended meaning. *Texas Dep't of Transp'n v. Garza*, 70 S.W.3d 802, 806 (Tex. 2002). The phrase "arbitrarily and capriciously" in Water Code § 49.2122(b) is used in the context of a challenge to a rate action taken by a district. It establishes the legal standard of proof that must be met to overcome the legal presumption established in Water Code § 49.2122. Primary jurisdiction over such a challenge is with the Texas Commission on Environmental Quality. It is reasonable therefore, when considering the meaning of "arbitrarily and capriciously," to determine the meaning of the phrase in the context of administrative proceedings.

15. The terms "arbitrary or capricious" are used in the Administrative Procedure Act when defining the scope of review of a decision in a contested case. *See* TEX. GOV'T CODE § 2001.174. Although these terms are not defined in the Administrative Procedure Act, case law has developed, in the context of administrative proceedings, regarding the terms "arbitrary and capricious," "arbitrarily or capriciously," and "arbitrary." When construing a statute, courts presume that the Legislature acted with knowledge of the common law and court decisions in enacting the statute. *Phillips v. Beaber*, 995 S.W.2d 655, 658 (Tex. 1999). It can be presumed that the Legislature chose the phrase "arbitrarily and capriciously" to establish the legal standard precisely because it was a standard commonly understood in the practice of administrative law.

Therefore, case law interpreting "arbitrary and capricious," "arbitrarily or capriciously," and "arbitrary" is instructive regarding the level of proof that TCR must produce to sustain its burden of showing that the District acted arbitrarily and capriciously.

16. The Third Court of Appeals has addressed the standard of proof necessary to establish "arbitrary and capricious" action in several cases. The court has stated, "An agency decision may be found arbitrary and capricious if it is based on legally irrelevant factors, or if legally relevant factors were not considered." *Sanchez v. Texas St. Bd. of Medical Examiners*, 229 S.W.3d 498, 508 n. 6 (Tex. App. – Austin 2007, no pet.); *Reliant Energy, Inc. v. Public Util. Com'n of Texas*, 153 S.W.3d 174, 195 (Tex. App. – Austin 2004, review denied); *Consumers Water, Inc. v. Public Util. Com'n of Texas*, 774 S.W.2d 719, 721 (Tex. App. – Austin 1989, no pet.). Agency decision that are not supported by substantial evidence are deemed arbitrary and capricious. *Public Util. Com'n of Texas v. Gulf States Utilities Co.*, 809 S.W.2d 201, 211 (Tex. 1991). Conversely, an administrative decision is generally not arbitrary and capricious if it is supported by substantial evidence. *Gerst v. Nixon*, 411 S.W,2d 350, 354 (Tex. 1966); *Hinkley v. Texas St. Bd. of Medical Examiners*, 140 S.W.3d 737, 743 (Tex. App. – Austin 2004, review denied). As noted above, substantial evidence is a limited standard of review, requiring only more than a mere scintilla of evidence to support an agency's determination. *Montgomery Indep. Sch. Dist. v. Davis*, 34 S.W.3d 559, 566 (Tex. 2000).

17. The Third Court of Appeals has also addressed the phrase "arbitrarily or capriciously." In *Meador-Brady Mgt. Corp. v. Texas Motor Vehicle Com'n*, 833 S.W.2d 683, 688 (Tex.App. – Austin 1992,), *rev'd on other grounds*, 866 S.W.2d 593 (Tex. 1993), Meador-Brady alleged that the Motor Vehicle Commission's order was arbitrary and capricious. The court stated, "In determining whether the Commission acted arbitrarily or capriciously, this

Court must determine whether the agency based its order on a consideration of all relevant factors and whether there is a rational connection between the facts and the agency's decision. This Court may not substitute its decision for that of the Commission." *Id.*, at 689.

18. In the context of a electricity rate case, the Texas Supreme Court has determined that an agency's decision is "arbitrary" if the agency: (1) fails to consider a factor the legislature directs it to consider; (2) considers an irrelevant factor; or (3) weighs only relevant factors that the legislature directs it to consider but still reaches a completely unreasonable result. *El Paso v. Public Util. Com'n of Texas*, 883 S.W.2d 179, 184 (Tex. 1994).

19. In summary, the Legislature included a specific legal standard that must be met to overcome the presumption that the District's rates are properly established. The specific legal standard, "arbitrarily and capriciously," is one that is well-established in the area of administrative law. Under this standard, the District's action will not be considered arbitrary and capricious if it is supported by substantial evidence. As noted above, substantial evidence is a limited standard of review, requiring only more than a mere scintilla of evidence to support the District's rate order. To meet its burden of proof, TCR must prove that there is no more than a mere scintilla of evidence to support the District's rate order.

VII.
Prayer

WHEREFORE, PREMISES CONSIDERED, Clear Brook City Municipal Utility District respectfully requests that on final hearing, the Administrative Law Judge order the following:

1. TCR Highland Meadow Limited Partnership's Motion for Reconsideration is denied;

2. TCR has the burden of proving that Clear Brook City Municipal Utility District acted arbitrarily and capriciously in adopting the rate order that is the subject of this proceeding;

3. To meet this burden, TCR must prove that the rate order is not supported by substantial evidence and to do so, TCR must prove that there is no more than a mere scintilla of evidence to support the rate order.

4. Such other and further relief to which Respondent may show itself justly entitled.

Respectfully submitted,

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UTILITY DISTRICT

SOAH DOCKET NO. 582-08-1700
TCEQ DOCKET NO. 2008-0091-UCR

PETITION OF RATEPAYERS APPEALING RATES ESTABLISHED BY CLEAR BROOK CITY MUNICIPAL UTILITY DISTRICT	§ § § § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

ORDER NO. 7
DENYING MOTION TO RECONSIDER ORDER NO. 6, DENYING MOTIONS CONCERNING LEVEL OF REQUIRED EVIDENCE, AND GRANTING MOTION TO EXTEND DEADLINE TO PROPOSE REVISED SCHEDULE

I. MOTION TO RECONSIDER

On October 23, 2008, TCR Highland Meadow Limited Partnership (TCR) filed a motion asking the Administrative Law Judge (ALJ) to reconsider a portion of Order No. 6. TCR asked that a hearing be set on its motion and argues that:

- Clear Brook City Municipal Utility District (Clear Brook), not TCR, should be required to prefile and present its direct case first;
- Clear Brook has the burden of proving its rates are just and reasonable; and
- TCR need only provide more than a scintilla of evidence that Clear Brook acted arbitrarily and capriciously in setting the rates in dispute.

On October 27, 2008, Clear Brook filed a response and asked the ALJ to hold a hearing and deny TCR's motion to reconsider and instead rule that:

- TCR must show that Clear Brook acted arbitrarily and capriciously in the adopting the rate order, and
- To meet that burden, TCR must show that there is no more than a scintilla of evidence to support Clear Brook's rate order.

When contacted by the ALJ's Assistant, the Executive Director (ED) and the Office of Public Interest Counsel (OPIC) indicated that they would not be filing responses to the motion to reconsider. The ALJ sees no reason to hold a hearing on TCR's motion, since it concerns issues of law, which the parties have thoroughly briefed. The motions for a hearing are denied.

EXHIBIT C

Additionally, TCR's motion to reconsider Order No. 6 is denied. The ALJ sees no error in the portion of the Order about which TCR complains. The ALJ still concludes that TCR has the initial burden of proof and should prefile and present its direct case first because Water Code § 49.2122(b):

- creates a presumption that Clear Brook's rates are just and reasonable;
- assigns to TCR the burden of proving that Clear Brook acted arbitrarily and capricious, which is synonymous with unjustly and unreasonably, in weighing and considering appropriate factors and properly establishing rates;
- is a later enacted statute that conflicts with 30 TEX. ADMIN. CODE (TAC) § 291.12, concerning burden of proof, and *Water Code § 49.2122(b) prevails*;
- does not, nor does Water Code § 49.2122(a), conflict with Water Code § 13.043(j), which requires Clear Brook's rates to be just, reasonable, *etc.*; and
- relieves Clear Brook of the burden of proving that its rates are just and reasonable, which it would otherwise have under Water Code § 13.043(j) and 30 TAC §291.12, until TCR first shows that Clear Brook acted arbitrarily and capriciously.

II. LEVEL OF REQUIRED PROOF

When Order No. 6 was issued only special exceptions, a discovery dispute, and a request to modify the procedural schedule—primarily to deal with burden of proof and the order of prefiling evidence—was before him. In the current pleadings, TCR and Clear Brook more specifically ask for rulings concerning the level of proof required to meet TCR's burden of proving that Clear Brook acted arbitrarily and capriciously in setting the disputed rates. The ALJ agrees that the case will be processed more efficiently if he rules on this issue at this time.

The level-of-proof dispute largely concerns scintillas, which are tiny amounts of something. Assuming for the sake of argument that it has any burden of proof, TCR claims that it must present only a bit more than a scintilla of evidence that Clear Brook acted arbitrarily and capriciously in setting the disputed rates. On the other hand, Clear Brook contends that TCR must show that there is no more than a scintilla of evidence to support Clear Brook's rate order. Both are incorrect.

Both Parties rely on administrative law cases decided under Tex. Gov't Code § 2001.174, its statutory ancestor, similar provisions in other statues, and similar principles developed by the courts in the absence of statutes on point. Section § 2001.174 summarize all of those and states:

> If the law authorizes review of a decision in a contested case under the substantial evidence rule or if the law does not define the scope of judicial review, a court may not substitute its judgment for the judgment of the state agency on the weight of the evidence on questions committed to agency discretion but:
>
> (1) may affirm the agency decision in whole or in part; and
>
> (2) shall reverse or remand the case for further proceedings if substantial rights of the appellant have been prejudiced because the administrative findings, inferences, conclusions, or decisions are:
>
> (A) in violation of a constitutional or statutory provision;
>
> (B) in excess of the agency's statutory authority;
>
> (C) made through unlawful procedure;
>
> (D) affected by other error of law;
>
> (E) not reasonably supported by substantial evidence considering the reliable and probative evidence in the record as a whole; or
>
> (F) arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion.

Thus, absent legal error, a reviewing court will almost never second-guess the weight assigned to the evidence by the agency that acted in a quasi-judicial capacity and considered the evidence presented by the parties to the dispute. The deference given to the administrative adjudicator's weighing of the evidence is enormous. As the Supreme Court of Texas summarized in *Texas Health Facilities Com. v. Charter Medical-Dallas, Inc.*, 665 S.W.2d 446, 453 (Tex. 1984):

> Although substantial evidence is more than a mere scintilla, *Alamo Express, Inc. v. Union City Transfer*, 158 Tex. 234, 309 S.W.2d 815, 823 (1958), the evidence in the record actually may preponderate against the decision of the agency and nonetheless amount to substantial evidence. *Lewis v. Metropolitan Savings and Loan Association*, 550 S.W.2d 11, 13 (Tex. 1977). The true test is not whether the agency reached the correct conclusion, but whether some reasonable basis exists in the record for the action taken by the agency. *Gerst v. Nixon*, 411 S.W.2d 350, 354 (Tex. 1966). A reviewing court is not bound by the reasons given by an agency in its order, provided there is a valid basis for the action taken by the agency. *Railroad Commission v. City of Austin*, 524 S.W.2d 262, 279 (Tex. 1975). Thus, the agency's action will be sustained if the evidence is such that reasonable minds could have reached the conclusion that the agency must have reached in

> order to justify its action. *Suburban Utility Corp. v. Public Utility Commission*, 652 S.W.2d 358, 364 (Tex. 1983).
>
> The findings, inferences, conclusions, and decisions of an administrative agency are presumed to be supported by substantial evidence, and the burden is on the contestant to prove otherwise. *Imperial American Resources Fund, Inc. v. Railroad Commission*, 557 S.W.2d 280, 286 (Tex. 1977). Hence, if there is evidence to support either affirmative or negative findings on a specific matter, the decision of the agency must be upheld. *Gerst v. Goldsbury*, 434 S.W.2d 665, 667 (Tex. 1968); see also *Lewis v. Jacksonville Building and Loan Association*, 540 S.W.2d 307, 311 (Tex. 1976).

Should either TCR or Clear Brook seek judicial review of the Commission's ultimate decision in this case, Section § 2001.174 would apply. A reviewing court would defer to the Commission's weighing of the evidence.

That leads TCR to argue that it need only provide a bit more than a scintilla of evidence that Clear Brook acted arbitrarily and capriciously. The ALJ does not agree. While only a small amount of evidence is needed to support a decision by the Commission on judicial review, the Commission demands a higher level of proof from a movant in a case before it. 30 TAC § 80.17 provides

> (a) The burden of proof is on the moving party by ***a preponderance of the evidence***, except as provided in subsections (b) . . .
>
> (b) Section 291.12 of this title (relating to Burden of Proof) governs the burden of proof in a proceeding involving a proposed change of water and sewer rates not governed by Chapter 291, Subchapter I of this title (relating to Wholesale Water or Sewer Service).
>
> ***
>
> (Emphasis added.)

As discussed in Order No. 6, 30 TAC §291.12 places the burden of proof on "the provider of water and sewer services." However, Water Code § 49.2122 (b) preempts that rule by requiring TCR to first show that Clear Brook acted arbitrarily and capriciously. To show that, the ALJ concludes that Rule 80.17(a) applies and requires TCR to first show by a preponderance of the

evidence that Clear Brook acted arbitrarily and capriciously. A little more than a scintilla will not do.

But Clear Brook argues that the required level of proof is even higher. It points to additional cases applying Tex. Gov't Code § 2001.174[1] and claims that they show that the courts have determined that something is not arbitrary and capricious if it is supported by substantial evidence, which need be only slightly more than a scintilla of proof. This leads Clear Brook to contend that TCR must show that there is no more than a scintilla of evidence to support the rates in dispute. The ALJ does not agree.

Clear Brook's argument rips cases out of their Texas Gov't Code § 2001.174 context. In those cases, the courts were not generally determining the meaning of arbitrary and capricious. Instead, they were determining the extent of the prohibition on a reviewing court's substituting its judgment concerning the weight of the evidence for that of the agency that acted as the neutral trier of fact and weighed the evidence. In that situation, the adjudicator is entitled to extreme deference.

Clear Brook is not entitled to that extreme deference. It did not hold a contested case and was not acting as a disinterested and impartial adjudicator when it set rates. Instead, it was acting as a seller and setting prices that it would charge TCR for service. Neither Section 2001.174 nor the long-established principles that underlie it apply in that situation. It is true that Water Code § 49.2122 creates a presumption in Clear Brook's favor, but a fair reading of that statutes does not entitle Clear Brook to the same deference accorded an adjudicative agency.

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[1] *Sanchez v. Tex. State Bd. of Med. Examiners*, 229 S.W.3d 498 (Tex. App. Austin 2007, no pet.); *Reliant Energy, Inc. v. PUC*, 153 S.W.3d 174 (Tex. App. Austin 2004, review denied); *Public Utility Com. v. Gulf States Utilities Co.*, 809 S.W.2d 201, 210 (Tex. 1991); *Gerst v. Nixon*, 411 S.W.2d 350 (Tex. 1966); *Hinkley v. Tex. State Bd. of Med. Exam'rs*, 140 S.W.3d 737 (Tex. App. Austin 2004, review denied); *Montgomery Indep. Sch. Dist. v. Davis*, 34 S.W.3d 559 (Tex. 2000); *Meador-Brady Management Corp. v. Texas Motor Vehicle Comm'n*, 833 S.W.2d 683 (Tex. App. Austin 1992), rev'd on other grounds, 866 S.W.2d 593, (Tex. 1993); and *City of El Paso v. Public Util. Comm'n*, 883 S.W.2d 179, 185 (Tex. 1994).

The ALJ concludes that Clear Brook is presumed to have weighed and considered appropriate factors and to have properly established rates absent a showing by a preponderance of the evidence that Clear Brook acted arbitrarily and capriciously.

III. EXTENSION OF DEADLINE TO FILE REVISED SCHEDULE

On October 29, 2008, TCR, with the concurrence of all parties, filed a motion to extend the October 29, 2008, deadline that Order No. 6 set for the parties to propose a revised procedural schedule. TCR asked for an extension until the ALJ ruled on TCR's motion to reconsider Order No. 6. The motion to extend is granted. The Parties shall confer and propose a new schedule by November 14, 2008.

SIGNED October 31, 2008.

WILLIAM G. NEWCHURCH
ADMINISTRATIVE LAW JUDGE
STATE OFFICE OF ADMINISTRATIVE HEARINGS

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COMMENTS:

Ms. Castanuela,

Please find enclosed for filing, Clear Brook City Municipal Utility District's Brief on the Administrative Law Judges' Request for Answers to Certified Questions.

Regards,
Kathleen Brown,
Assistant to Paul Sarahan

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